No. 17,046

IN THE

United States Court of Appeals

For the Ninth Circuit

CAL-NEVA LODGE, INC., a Nevada corporation,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

On Appeal from the Order of the United States District Court for the District of Nevada

BRIEF FOR THE APPELLEE

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BRIEF FOR THE APPELLEE

OPINION BELOW

The opinion and order of the District Court (R. 34-46) are reported at 186 F. Supp. 187.

JURISDICTION

This action involves the allowability of a claim of the United States against Cal-Neva Lodge, Inc., for failure to honor a levy. On June 1, 1953, the United

States levied upon all property in possession of Cal-Neva Lodge, Inc., belonging to Elmer and Helen Remmer, for taxes owed by the Remmers to the United States. Cal-Neva Lodge, Inc., made no payment to the United States pursuant to the levy. (R. 32.) On November 12, 1955, Cal-Neva Lodge, Inc., instituted the instant proceedings under Chapter XI of the Bankruptcy Act. (R. 29.) On December 27, 1955, the District Director filed proof of claim in these proceedings setting forth a priority claim against Cal-Neva Lodge, Inc., in a sum equal to the value of the property not surrendered. (R. 7-8, 11, 17.) On April 18, 1959, the referee in bankruptcy entered an order disallowing this claim. (R. 28-33.) On May 26, 1959, the United States filed a petition for review of the order of the referee. (R. 26-27, 35.) On June 27, 1960, the District Court set aside the order of the referee and allowed the claim as a priority claim. (R. 45-46.) The case is brought to this Court by a notice of appeal filed by Cal-Neva Lodge, Inc., on July 26, 1960. (R. 46.) Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291, and the Bankruptcy Act, Section 24.

QUESTIONS PRESENTED

1. Whether the District Court correctly held that the levy of the United States effectively seized the secured obligation owed by the debtor to the Remmers so that the debtor in failing to honor the levy became personally liable to the United States under Section

3710(b) of the 1939 Code in the amount of the indebtedness.

2. Whether the District Court properly held that the claim of the United States under Section 3710(b) is for the collection of a pecuniary loss rather than a penalty to be disallowed under Section 57(j) of the Bankruptcy Act.

STATUTES INVOLVED

The statutes involved are set forth in the Appendix, *infra.*

STATEMENT

The facts, as found by the referee (R. 29-32) and adopted by the District Court (R. 36-38), are as follows:

On December 31, 1948, Cal-Neva Lodge, Inc., hereinafter referred to as the debtor, purchased the Cal-Neva Lodge, a property located in both the States of Nevada and California, from Elmer P. Remmer and Helen L. Remmer. The amount of the purchase price remaining unpaid on the Cal-Neva Lodge property was evidenced by a note executed by the debtor to the Remmers. The note provided for interest at the rate of 4% per annum. The note was secured by a purchase money first deed of trust executed by the debtor to the Remmers. (R. 31.)

Subsequently, the Remmers became involved in tax difficulties with the United States. Thereafter, on

June 1, 1953, the United States, pursuant to Section 3692 of the Internal Revenue Code of 1939, levied upon the secured obligation of the debtor which was owing to the Remmers.[1] At the time of the levy, the debtor owed the Remmers $198,333.34, plus accrued interest at 4% from December 31, 1948. The indebtedness was not subject to any attachment or execution under judicial process at the time of the levy. (R. 31-32, 36-37.)

After the levy, the debtor sold the Cal-Neva Lodge property to Park Lake Enterprises, Inc., which agreed to assume the secured obligation to the Remmers. (R. 38.) No payment has been made by the debtor to the United States pursuant to the levy. (R. 32.)

On November 12, 1955, the debtor instituted proceedings under Chapter XI of the Bankruptcy Act. The United States filed a proof of claim on December 27, 1955, setting forth a priority claim as a result of its levy on the secured obligation owing by the debtor to the Remmers.[2] (R. 29-30.) The referee disallowed

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[1]The levy, Treasury Form 668-A as revised in November, 1953, actually notified the debtor "that all property, rights to property, moneys, credits and/or bank deposits now in your possession and belonging to the aforesaid taxpayer and all sums of money owing from you to the said taxpayer are hereby seized and levied upon for the payment of the aforesaid tax * * *."

[2]In its proof of claim, the United States also set forth claims for certain corporate income, withholding, F.I.C.A. and F.U.T.A. taxes which had been assessed against the debtor. (R. 3-18.) The parties stipulated that the portion of the claim relating to withholding and F.I.C.A. taxes for the fourth quarter of 1955 in the sum of $16,317.33, additional withholding and F.I.C.A. taxes for the third quarter of 1955 in the sum of $736.57, and F.U.T.A. taxes for the year 1955 in the sum of $2,434.98 should be allowed.

this claim as invalid on the ground that under California and Nevada law, the Remmers themselves could not claim any liability on the note but are required to look to the security first for payment. (R. 22-25.) On petition for review of the referee's order filed by the United States, the District Court reversed the referee's order and held the United States has a priority claim under Section 64 of the Bankruptcy Act, stating that collection of federal taxes is governed by federal law and that under federal law, the levy on the secured obligation in favor of the Remmers was completely effectual. (R. 34-46.) The District Court further held that the claim should not be disallowed as a penalty.

SUMMARY OF ARGUMENT

Sections 3670, 3690, 3692 and 3710 of the Internal Revenue Code of 1939 provide that if any person liable to pay any tax neglects or refuses to pay the tax after demand, the amount of the tax becomes a lien in favor of the United States upon all property, whether real or personal; that if the taxpayer neglects or refuses to pay the tax after notice and demand is made upon him, the Government may levy upon all property or rights to property belonging to the taxpayer or on

(R. 30, 16.) The United States abandoned its claim for the corporate income taxes after it had filed a petition for review of the referee's order by filing an amended claim eliminating all claims for income taxes and penalties and interest thereon. (R. 36.) Thus the only matter in controversy in the District Court and in this Court relates to the amount claimed as the result of the levy of June 1, 1953, on the secured obligation owed by the debtor to the Remmers.

which there is a lien; that the person who is in possession of property which is subject to levy shall, upon demand, surrender such property to the Government and, if such person fails or refuses to do so, he is liable in his own person or estate to the United States in a sum equal to the value of the property (not to exceed the amount of the taxes for the collection of which the levy has been made).

In the instant case, on June 1, 1953, the United States, pursuant to Section 3692, levied upon property owed by the debtor to Elmer and Helen Remmer, for taxes due and owing by the Remmers to the United States. The debtor did not honor the levy. Accordingly, the debtor is personally liable to the United States under Section 3710(b) of the 1939 Code in a sum equal to the value of the property not surrendered unless it can show (1) that it was not in possession of property of the taxpayer which was subject to levy or (2) that the property was subject to a prior judicial attachment or execution. The statute admits of no other defenses. Neither of these defenses, however, is available to the debtor in the instant case as the undisputed facts of record show.

There is no question that the debtor was indebted to the Remmers at the time of the levy and that this indebtedness was not subject to any attachment or execution under any judicial process at the time of the levy. There is also no question that this indebtedness was secured by property which was in the debtor's possession and which it was using at the time of the levy. Nor is there any question that the indebtedness

and the security qualify as "property" or "rights to property" within the meaning of the foregoing Code sections, against which a lien may attach and a levy may be made.

The debtor, nevertheless, contends that under California law the only remedy available to the Remmers in collecting on the indebtedness owing to them was judicial foreclosure; that the United States, by its levy of June 1, 1953, is in the same position as the Remmers and possessed of the same rights had by the Remmers under state law; and that, accordingly, the United States had one form of action available to it—namely, judicial foreclosure—and it seized nothing by the levy. This argument—that the Remmers could not maintain an *in personam* action on the note—does not establish, however, that the debtor had no property or rights to property belonging to the Remmers. Rather, it ignores the plain facts of record, which establish beyond question that it had both liability and property belonging to the Remmers which the levy could reach. The particular California procedural requirements for enforcing the debtor's liability and the interest of the Remmers in the property cannot detract from the plain actuality that such liability and such property and rights were in fact and in law in debtor's possession and could be reached by the levy.

If there are sufficient interests existing under state law to qualify as "property" or "rights to property" within the meaning of the Code, state law is inoperative to prevent the United States from levying effectively on such "property" or "rights to property."

The courts have uniformly recognized this principle. The District Court properly noted and gave effect to it.

Since, in the instant case, the debtor had liability owing to and property interest belonging to the Remmers at the time of the levy which were "property" or "rights to property" within the meaning of the pertinent sections of the Internal Revenue Code against which a lien could attach and a levy could be made, the levy of June 1, 1953, was effective to seize such property or right to property regardless of any provisions of state law to the contrary. After the levy and the failure of the debtor to surrender the property or the rights to property in its possession, the procedure for enforcement of these rights arising in favor of the United States as a result of the failure to honor the levy is a matter of federal law. The federal statute imposes a liability upon the debtor to the United States of a sum equal to the value of the property or rights not surrendered.

Thus, clearly, the debtor is personally liable to the United States for its failure to honor the levy of June 1, 1953, pursuant to the provisions of Section 3710(b). Under Section 64(a)(5) of the Bankruptcy Act the claim of the United States is a priority claim.

Further, the claim of the United States herein is not barred by Section 57(j) of the Bankruptcy Act, as the District Court correctly held. As shown by the legislative history and the decided cases, the clear purpose of Section 3710(b) is not to punish but rather is to secure collection of property in the hands of a

third person which belongs to a taxpayer indebted to the United States. Thus, a claim under Section 3710(b) is pecuniary, not penal, and is collectible in a bankruptcy proceeding.

ARGUMENT

I

THE DISTRICT COURT CORRECTLY HELD THAT THE DEBTOR IN FAILING TO HONOR THE LEVY OF THE UNITED STATES UPON A SECURED OBLIGATION OWED BY IT TO THE REMMERS BECAME PERSONALLY LIABLE TO THE UNITED STATES UNDER SECTION 3710(b) OF THE 1939 CODE IN THE AMOUNT OF THE SECURED OBLIGATION SO THAT THE CLAIM OF THE UNITED STATES FOR THIS AMOUNT IS A PRIORITY CLAIM UNDER SECTION 64 OF THE BANKRUPTCY ACT

The lien for federal taxes, and the provisions for the collection thereof, are strictly federal and strictly statutory. *Bank of Nevada v. United States,* 251 F.2d 820, 824 (C.A. 9th), certiorari denied, 356 U.S. 938; *United States v. Christensen,* 269 F.2d 624, 637 (C.A. 9th). As this Court pointed out in the *Bank of Nevada* case (p. 821), "No government worthy of its name will permit itself to be rendered incapable of collecting the public fisc."

The Internal Revenue Code of 1939 provides that, if any person liable to pay any tax neglects or refuses to pay the tax after demand, the amount of the tax becomes a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person. Section 3670 of the Internal Revenue Code of 1939, Appendix, *infra.* If

the person who is liable to pay the tax neglects or refuses to do so within ten days after notice and demand is made upon him, the Secretary (of the Treasury) or his delegate may collect such tax by levy upon all property and rights to property (with certain exceptions not pertinent here) belonging to such person or on which there is a lien. Sections 3690 and 3692 of the Internal Revenue Code of 1939, Appendix, *infra*. Upon such a levy, any person who is in possession of property or rights to property which are subject to the levy shall, upon demand, surrender such property or rights to the Secretary or his delegate, unless the property is, at the time of demand, subject to an attachment or execution under any judicial process. Any person who, upon demand, fails or refuses to surrender property or rights to property which is subject to levy is liable in his own person or estate to the United States in a sum equal to the value of the property not surrendered (not to exceed the amount of the taxes for the collection of which the levy has been made) together with costs and statutory interest from the date of levy. Section 3710(a) and (b) of the Internal Revenue Code of 1939, Appendix, *infra*.

In the instant case, the United States, pursuant to Section 3692, levied upon property owed by the debtor to Elmer and Helen Remmer, for taxes owed by the Remmers to the United States. (R. 31-32.)[3] The debtor did not honor the levy. Accordingly, it is

[3]The Commissioner had assessed deficiencies, interest and penalties against the Remmers in an amount exceeding $800,000. See *Remmer v. United States*, 205 F.2d 277.

personally liable to the United States under Section 3710(b) of the 1939 Code in a sum equal to the value of the property not surrendered. The claim of the United States here is for this indebtedness to it.[4]

The terms of Section 3710(a) of the Internal Revenue Code of 1939 permit the debtor only two defenses by which it can avoid personal liability for failing to honor a levy: (1) That it was not in possession of property of the taxpayer which was subject to levy, or (2) that the property was subject to a prior judicial attachment or execution. The statute admits of no other defenses. *Bank of Nevada v. United States, supra; United States v. Manufacturers Trust Co.,* 198 F.2d 366 (C.A. 2d); *Commonwealth Bank v. United States,* 115 F.2d 327 (C.A. 6th). Neither of these defenses is available to the debtor in the instant case as the undisputed facts of record show.

The referee found as facts (R. 32):

> That at the time of said levy, Cal Neva Lodge, Inc., was indebted to the Remmers in the amount

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[4]As noted, *supra,* the debtor, subsequent to the levy, transferred the Cal-Neva Lodge property to Park Lake Enterprises, Inc., and the latter assumed the obligation to the Remmers. The United States thereupon served a notice of levy on Park Lake in order to collect the taxes owed by the Remmers; this notice of levy was also not honored. Action is now pending against Park Lake in the United States District Court for the District of Nevada for a sum equal to the value of the property not surrendered, pursuant to Section 3710(b) of the 1939 Code. It has at all times been understood in these cases that the Government does not seek to collect the value of the indebtedness more than once. (R. 43.) The Government is simply protecting its interest in collecting one time by proceeding against both the debtor and Park Lake. Amounts collected from either will be applied to reducing the liability of both as well as the liability of the Remmers. I.T. 2577, X-I Cum. Bull. 300 (1931).

> of $198,333.34, plus accrued interest at 4% from December 31, 1948, which was evidenced and secured by the promissory note and deed of trust referred to in paragraph V. Said indebtedness was not subject to any attachment or execution under any judicial process at the time of the levy.

These findings were approved by the District Court (R. 37) where apparently they were not challenged, and they are not challenged here. Thus, there is no question that the debtor, Cal-Neva Lodge, Inc., was indebted to the Remmers at the time of the levy. Further, as the District Court pointed out, the obligation was due at that time. (R. 44.)

The question of whether this secured obligation qualifies as "property" or "rights to property" within the meaning of the Code sections discussed *supra* is a federal question. *Fidelity & Deposit Co. v. New York City Housing Authority,* 241 F.2d 142 (C.A. 2d). The courts have given the words "property" or "rights to property", as used in these statutory provisions, broad meanings. They are held to include obligations, debts owing to the taxpayer, and other intangibles. *United States v. Eiland,* 223 F.2d 118 (C.A. 4th); *United States v. Graham,* 96 F. Supp. 318 (S.D. Calif.), affirmed *sub nom. State of California v United States,* 195 F.2d 530 (C.A. 9th), certiorari denied, 344 U.S. 831. As the Fourth Circuit stated in the *Eiland* case (p. 121):

> There can be no question, we think, but that the lien for taxes provided by the statute can be asserted against intangible property such as a

> debt. [Citing many cases.] And we think it equally clear that the proper way to assert the lien is by levy and notice such as was served here. * * *

Accord: *Bank of Nevada v. United States, supra; In the Matter of Cherry Valley Homes, Inc.,* 255 F.2d 706 (C.A. 3d), certiorari denied, 358 U.S. 864. Thus, it is clear that the debt owing to the Remmers is "property" or "rights to property" against which a lien may attach and a levy may be made, under the statutes here involved.

The debtor, nevertheless, contends that it was not in possession of any property of the Remmers which was subject to levy on June 1, 1953. (Br. 7-10.) Its argument is that under California law the only remedy available to the Remmers in collecting on the indebtedness owing to them was judicial foreclosure;[5] that the United States, by its levy of June 1, 1953, is in the

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[5]The provisions cited by the debtor (Sections 580(b) and 726 of the California Code of Civil Procedure) were enacted to prevent creditors from bidding in the debtor's real property at a nominal figure and then also holding the debtor personally liable for a large proportion of the debt. *Hatch v. Security First National Bank,* 19 Cal.2d 254, 259; 22 Cal. L.R. 170, 180. These sections presuppose the existence of a debt and pertain simply to the remedies of the creditor in the event of default.

Morover, the property was only in part located in California; in part it was located in Nevada (R. 31) and thus since Nevada was to some extent the place of performance of debtor's obligation under the note and trust deed, Nevada law would apply. No provision of Nevada law similar to Section 580(b) of the California Code of Civil Procedure is invoked by the debtor nor has come to our attention which would deny a deficiency recovery in the case of a purchase money transaction. However, for the reasons stated in the body of the argument these provisions of state law are irrelevant in the face of the rights created in favor of the Government under Section 3710.

same position as the Remmers and possessed of the same rights had by the Remmers under state law; and that, accordingly, the United States had one form of action available to it—namely, judicial foreclosure—and it seized nothing by the levy. This argument—that the Remmers could not maintain an *in personam* action on the note—does not establish, however, that the debtor had no property or rights to property belonging to the Remmers. Rather, it ignores the plain facts of record. The record establishes that at the time of the levy the debtor had in its possession and was using in its business the Cal-Neva Lodge property. The record further establishes that the Remmers had an interest in this property to the value of and which secured the indebtedness owing to them by the debtor. Thus, quite clearly, the debtor was in possession at the time of the levy of property or a property interest belonging to the Remmers, which debtor failed to surrender. This property interest was seized by the levy of the United States which was on "*all property, rights to property* * * * now in your possession and belonging to the * * * [Remmers]." (Emphasis supplied.)[6] The debtor failed to turn over that property or to pay over the indebtedness; instead, it proceeded to occupy, use and enjoy the property after the levy, and eventually sold the property to Park Lake Enterprises. In doing so, however, it did not, and could not, defeat the levy of the United States. Debtor cannot take the position in the face of the levy of asserting that despite its note and the trust deed and its posses-

[6]See, fn. 1, *supra.*

sion and control of the valuable property securing its debt, it had neither liability nor property belonging to the Remmers which the levy could reach. The particular California procedural requirements for enforcing the debtor's liability and the interest of the Remmers in the property cannot detract from the plain actuality that such liability and such property and rights were in fact and in law in debtor's possession and could be reached by the levy.

The remedy afforded the Government by Section 3710(b) is significant and would appear intended to protect the Government against a position such as that which debtor here asserts. Section 3710(b) provides, as noted, that any person who fails to honor a levy is liable "in a sum *equal to* the value of the property or rights not so surrendered". (Emphasis supplied.) The debtor having held this property and rights to property belonging to the Remmers at the time of the levy is liable to the United States in a sum equal to the value of the Remmers' interest therein (the amount of the indebtedness) for failing to turn the property or the money owed over to the United States pursuant to the levy.

If there are sufficient interests existing under state law to qualify as "property" or "rights to property" within the meaning of the Code, state law is inoperative to prevent the United States from levying effectively on such "property" or "rights to property". The courts have uniformly recognized this principle.[7]

[7]The debtor does not cite any cases which hold to the contrary. *United States v. Winnett,* 165 F.2d 149 (C.A. 9th), and *United*

The District Court properly noted and gave effect to it.

The Supreme Court expressly recognized this principle in *United States v. Bess,* 357 U.S. 51. The Court therein rejected the argument that since under state law the cash surrender value of life insurance policies is not subject to creditor's liens, whether asserted by a private creditor or by a state agency, the federal liens could not attach to the cash surrender value of such policies. The Court held that the federal liens attached, stating (pp. 56-57):

> However, once it has been determined that state law creates sufficient interests in the insured to satisfy the requirements of Section 3670, state law is inoperative to prevent the attachment of liens created by federal statutes in favor of the United States.

In like manner, in *Bank of Nevada v. United States, supra,* this Court rejected the bank's contention that it did not have in its possession "property" or "rights to property" subject to levy. The bank argued that under state law it had a general lien or right of set-off against the deposits of the depositor; that it had a right of set-off also by virtue of an agreement with the taxpayer-depositor and its right of set-off depleted the funds levied upon. This Court stated (pp. 709-713):

States v. Graham, 96 F. Supp. 318 (S.D. Calif.), affirmed *sub nom. State of California v. United States,* 195 F.2d 530 (C.A. 9th), certiorari denied, 344 U.S. 831, upon which it relies principally, simply hold that the Government cannot seize by its levy property in excess of that owed to the creditor at the time of the levy. See *Bank of Nevada v. United States, supra,* p. 713.

> The Supreme Court has repeatedly and emphatically stated that Federal tax liens and the provisions for their collection are strictly *Federal* and strictly *statutory*. Those provisions are unaffected by any alleged "general rule" that a bank has a "general lien" upon deposits.
>
> * * * * * * *
>
> No strained theories of setoff, relation back, or the like can frustrate the sovereign from collecting its taxes in this case. The stubborn principle remains, under the facts of this case, that the appellant is liable for failing to surrender, after levy and demand, the bank account to which the liens had attached.

Similarly, in *United States v. Manufacturers Trust Co.,* 198 F.2d 366 (C.A. 2d), the bank's assertion that it was not liable for failing to honor a levy on a savings account was held to be without merit. The bank relied upon state law in support of its position that the relationship between it and the depositor-taxpayer was that of debtor-creditor and that under state law it was not obliged to make payments out of the savings account except in conformity with the contract which created that relationship. The contract required the presentation of the depositor's passbook upon request for payments which the United States did not do. Thus, the bank argued, as the debtor in the case at bar and the bank in the *Bank of Nevada* case, that the distraint had no more effect than to put the United States in the position of the creditor *vis-a-vis* the debtor in accordance with state law. The Court rejected this contention stating (p. 368):

> However, the remedy of the government to enforce collection of taxes by the summary administrative method of distraint is not so limited in its effect and is a special privilege it has which is analogous to, but in addition to, garnishment and other remedies of an ordinary creditor. (citing cases) It is a constitutionally valid expedient for the collection of taxes necessary to the very existence of government (citing cases) and has been available by law since 1791. In 1926 this remedy of the government was extended in the statutes above mentioned to permit the seizure of the property of a taxpayer in the hands of a third party * * *.

Also, *In the Matter of Cherry Valley Homes, Inc., supra,* the argument that the United States upon levying on an indebtedness was in no better position than the creditor with respect to collecting the indebtedness was held to be meritless. In the *Cherry Valley Homes* case, the United States levied on an indebtedness owing by Cherry Valley Homes, Inc. (Cherry Valley), to the M. Tobin Company (Tobin). Cherry Valley failed to honor the levy. Subsequently, Cherry Valley filed a voluntary petition for reorganization under Chapter X of the Bankruptcy Act and the United States filed a proof of claim for a sum equal to the amount which Cherry Valley had failed to surrender pursuant to the notice of levy. The referee with the approval of the District Court (1 A.F.T.R.2d 989) held that the claim of the United States was not a priority claim since if the Government had not levied upon the debt, Tobin would have shared pro-rata with

other unsecured creditors of Cherry Valley in the assets available for unsecured creditors. The Third Circuit reversed, holding that the United States had a priority claim. The court said (pp. 707-708):

> In legal contemplation and consequence, this levy effectively and exclusively appropriated the debt to the satisfaction of the tax claim six months before the Chapter X proceeding was instituted. [Citing cases.] Such a levy is treated in law like a seizure of corporeal property, taken into the possession of a collector by way of distraint for taxes. * * *
>
> Alternatively, as the government urges here, since the possessory concept of "seizure" is not strictly applicable to a debt, it seems correct to say that the tax levy through process served upon the debtor at least accomplished an assignment of the Tobin's claim against Cherry Valley to the United States by operation of law. This approach brings into decisive effect the provision of Revised Statutes, Section 3466, 31 U.S.C. Sec. 191, that "whenever any person indebted to the United States is insolvent * * * the debts due to the United States shall be first satisfied." * * *
>
> Finally, it is argued in a general way that there is some lack of equity in the priority thus accorded the government. But we see no inequity in recognizing that the government acquired a priority over general creditors when its claim was asserted and perfected against the debt owed by Cherry Valley many months before Chapter X proceedings were instituted.

In the instant case, as we have shown, the debtor had liability owing to and property interest belonging

to the Remmers at the time of the levy which were "property" or "rights to property" within the meaning of the pertinent sections of the Internal Revenue Code against which a lien could attach and a levy could be made. Accordingly, the levy of June 1, 1953, was, as the decided cases show, effective to seize such property or rights to property regardless of any provisions of state law. After the levy and the failure of the debtor to surrender the property or the rights to property in its possession, the procedure for enforcement of these rights arising in favor of the United States as a result of the failure to honor the levy is a matter of federal law. The federal statute imposes a liability upon the debtor to the United States of a sum equal to the value of the property or rights not surrendered. *Bank of Nevada v. United States, supra.*

Thus, clearly, the debtor, pursuant to the provisions of Section 3710(b), is personally liable to the United States for its failure to honor the levy of June 1, 1953. Under Section 64(a)(5) (11 U.S.C. 1952 ed., Sec. 104) of the Bankruptcy Act, Appendix, *infra,* the claim of the United States is a priority claim. The District Court was clearly correct in so holding and should be affirmed.

II

THE DISTRICT COURT WAS CORRECT IN HOLDING THAT THE CLAIM OF THE UNITED STATES UNDER SECTION 3710(b) IS FOR THE COLLECTION OF A PECUNIARY LOSS AND IS NOT A PENALTY TO BE DISALLOWED UNDER SECTION 57(j) OF THE BANKRUPTCY ACT

The debtor further raises on appeal the question of whether Section 3710(b) imposes a penalty or provides for the collection by the United States of a pecuniary loss. The debtor claims it imposes a penalty and that accordingly the claim of the United States herein is barred by Section 57(j) of the Bankruptcy Act, Appendix, *infra*. We submit that the clear purpose of Section 3710(b), as shown by the legislative history and the decided cases, is not to punish but rather is to secure collection of property in the hands of a third person which belongs to a taxpayer indebted to the United States. Thus, a claim under Section 3710(b) is pecuniary, not penal, and is collectible in a bankruptcy proceeding.

Section 3710(b) was originally enacted as Section 1114(e) of the Revenue Act of 1926, C. 27, 44 Stat. 9. In its report, S. Rep. No. 52, 69th Cong., 1st Sess., p. 38 (1939-1 Cum. Bull. (Part 2) 332, 360), the Senate Committee on Finance in explanation of the proposed liability to be created by Section 1114(e) said that it is "a liability similar to that of an executor who pays debts before he pays a debt due the United States". Thus, personal liability arises when all of the funds belonging to the taxpayer coming into the possession of the person levied upon are expended by the latter to satisfy debts other than those due to the

United States. As stated in I.T. 2577, X-1 Cum. Bull. 300, 301 (1931), "In short, the statute does not create a dual monetary liability existent at one and the same time".

In the light of the legislative history, the Revenue Service ruled in I.T. 2577, *supra,* that money collected from a bank in a suit under Section 1114(e) was not to be treated as a penalty but was to be credited against the tax liability of the taxpayer to whom the bank was indebted. As stated, footnote 4, *supra,* any amount collected herein from the debtor will be applied to reducing the tax liability of the Remmers.

The decided cases have made it clear that Section 3710(b) does not impose a penalty. This Court quoted with approval in *Bank of Nevada v. United States, supra,* p. 828, the observation of the Fourth Circuit in *United States v. Eiland, supra,* pp. 121-122, that "* * * payment to the government pursuant to the levy and notice is a complete defense to the debtor against any action brought against him on account of the debt. [Cases cited.]" The Second Circuit in *United States v. Metropolitan Life Insurance Co.,* 130 F.2d 149, 151, said:

> It is true that this action was called a "penalty," but it was really not that, for title would undoubtedly pass upon payment so that the holder would suffer no loss.

Thus, the courts have recognized that the personal liability provided in Section 3710(b) is merely a collection of the original amount owing from the person levied upon to the taxpayer. The fact that this provi-

sion is in the guise of a penalty, being entitled "Penalty for violation", is not controlling; it is the actual purpose and operation of the statute which governs. See also *In re Haynes,* 88 F. Supp. 379 (Kans.).

For these reasons, we submit that the District Court was quite correct in devoting "but little time to the 'penalty' issue so earnestly raised by the debtor". (R. 40.) The claim of the United States is clearly allowable. See also, *Simonson v. Granquist* (C.A. 9th), decided February 1, 1961 (1961-1 U.S.T.C., par. 9226), petition for rehearing pending, and *United States v. Harris* (C.A. 9th), decided February 1, 1961 (1961-1 U.S.T.C. par. 9227), petition for rehearing pending.

CONCLUSION

The order of the District Court is correct and should be affirmed.

Respectfully submitted,

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March, 1961.

(Appendix Follows.)

Appendix.

Appendix

Internal Revenue Code of 1939:

SEC. 3670. PROPERTY SUBJECT TO LIEN.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

(26 U.S.C. 1952 ed., Sec. 3670.)

SEC. 3671. PERIOD OF LIEN.

Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time.

(26 U.S.C. 1952 ed., Sec. 3671.)

SEC. 3690. AUTHORITY TO DISTRAIN.

If any person liable to pay any taxes neglects or refuses to pay the same within ten days after notice and demand, it shall be lawful for the collector or his deputy to collect the said taxes, with such interest and other additional amounts as are required by law, by distraint and sale, in the manner provided in this subchapter, of the goods, chattels, or effects, including stocks, securities, bank accounts, and evidences of debt, of the person delinquent as aforesaid

(26 U.S.C. 1952 ed., Sec. 3690.)

SEC. 3692. LEVY.

In case of neglect or refusal under section 3690, the collector may levy, or by warrant may authorize a deputy collector to levy, upon all property and rights to property, except such as are exempt by the preceding section, belonging to such person, or on which the lien provided in section 3670 exists, for the payment of the sum due, with interest and penalty for nonpayment, and also of such further sum as shall be sufficient for the fees, costs, and expenses of such levy.

(26 U.S.C. 1952 ed., Sec. 3692.)

SEC. 3710. SURRENDER OF PROPERTY SUBJECT TO DISTRAINT.

(a) *Requirement.*—Any person in possession of property, or rights to property, subject to distraint, upon which a levy has been made, shall, upon demand by the collector or deputy collector making such levy, surrender such property or rights to such collector or deputy, unless such property or right is, at the time of such demand, subject to an attachment or execution under any judicial process.

(b) *Penalty for Violation.*—Any person who fails or refuses to so surrender any of such property or rights shall be liable in his own person and estate to the United States in a sum equal to the value of the property or rights not so surrendered, but not exceeding the amount of the taxes (including penalties and interest) for the collection of which such levy has been made, together with costs and interest from the date of such levy.

* * * * * * *

26 U.S.C. 1952 ed.,Sec. 3710.)

Bankruptcy Act, c. 541, 30 Stat. 544:

SEC. 57 [As amended by Sec. 1, Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 14, Act of July 7, 1952, c. 579, 66 Stat. 420]. *Proof and Allowance of Claims.*—

* * * * * * *

(j) Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law.

* * * * * * *

(11 U.S.C. 1958 ed., Sec. 93.)

SEC. 64. [As amended by Sec. 1, Act of June 22, 1938, *supra*]. Debts Which Have Priority.—a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; * * * the costs and expenses of administration, * * * (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided,* That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: *And provided further,* That, in case any question arises as to the amount or legality of any taxes, such question shall be

heard and determined by the court; and (5) debts owing to any person including the United States, who by the laws of the United States in [sic] entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law: * * *.

* * * * * * *

(11 U.S.C. 1958 ed., Sec. 104.)